MAR 5 1956
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

No. 733

OCTOBER TERM, 1955

WESTERN MARYLAND RAILWAY COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Baltimore, Maryland
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UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Western Maryland Railway Company prays that a writ of certiorari be issued to review a judgment of the United States Court of Appeals for the Fourth Circuit, affirming a judgment of the United States District Court for the District of Maryland in favor of the defendant, in an action by Petitioner for the recovery of excess profits taxes.

OPINIONS BELOW

The opinion of the District Court, which is quoted in full beginning at page 3 of Petitioner's appendix as printed for the Court below, is reported at 131 Fed. Supp. 873.

The opinion of the Court of Appeals is printed in full as Appendix "A" to this petition, and is reported in 227 Fed. 2nd 576.

JURISDICTION

(i) The judgment, review of which is sought, was dated and entered in the United States Court of Appeals for the Fourth Circuit on December 6, 1955.

(ii) There has been no order granting or denying rehearing in the Court below, or extending the time within which to petition for certiorari.

(iii) The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1) and Section 2101(c).

QUESTION PRESENTED FOR REVIEW

Can Section 718(a) of the Internal Revenue Code of 1939 requiring that equity invested capital *"shall be the sum of"* money paid in and property other than money paid in, and the regulations applicable thereunder, be construed to permit the Commissioner of Internal Revenue to make a lawful determination of equity invested capital without determining the "sum of" these elements?

STATUTES AND REGULATIONS INVOLVED

This petition involves the construction and proper application of the following provisions of the Internal Revenue Code of 1939 and regulations relating to the determination of equity invested capital.

> "Sec. 718. (a) DEFINITION. — The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—
>
> > (1) MONEY PAID IN. — Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) PROPERTY PAID IN. — Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. * * *"

(See 26 U. S. Code Annotated, Excess Profits Taxes, Section 718).

"SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) BASIS (UNADJUSTED) OF PROPERTY. — The basis of property shall be the cost of such property; * * *"

(Internal Revenue Code of 1939, 26 U. S. Code, 1952 Ed., Sec. 113(a)).

"Reg. 112, Sec. 35.718-1. Determination of daily equity invested capital — Money and property paid in. — The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in surplus, or as a contribution to capital. The terms 'money paid in' and 'property paid in' do not include amounts received as premiums by an insurance company subject to taxation under section 204. For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. * * *"

"If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. * * *"

(C. C. H. Excess Profits Tax Reporter, 1946, Vol. 3A, Sec. 5087).

STATEMENT OF THE CASE

Petitioner brought three actions[1] in the United States District Court for the District of Maryland against the United States for recovery of excess profits taxes which it alleges were unlawfully collected for the taxable calendar years 1943, 1944 and 1945. The District Court had jurisdiction over these actions under Title 28 U. S. C., Section 1346(a)(1).

The actions charged that the excess profits credit allowed to Petitioner by the Commissioner of Internal Revenue for the years 1941 to 1946, inclusive, was incorrectly determined because, among other things, the Commissioner failed to include in Appellant's equity invested capital $6,274,160 of money paid in which should have been included in computing Petitioner's excess profits credit. This resulted in the payment of excess profits taxes for the years 1943, 1944 and 1945, which Petitioner alleges were excessive by more than $2,500,000.[2]

The parties stipulated in the trial court that the correctness of the Commissioner's determination depends upon the effect on Petitioner's equity invested capital of a reorganization effective January 1, 1910, in which the railroad and *property* of Western Maryland Rail *Road* Company (hereinafter sometimes called "the old company") was conveyed to Petitioner's immediate predecessor, *The* Western Maryland Rail*way* Company (hereinafter sometimes called "the new company") in exchange for its preferred and common

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[1] These actions were consolidated for trial and were heard on appeal on a single record.

[2] The amount of additional taxes and interest paid by Petitioner are stated at page 45 of Petitioner's Appendix in the Court below. Computation of the extent to which these amounts constitute overpayments, and the interest thereon, has by agreement been postponed until after final decision in these cases (Petitioner's Appendix, page 20).

stock, and accompanied by payment by the bondholders and stockholders of new *money* capital to the new company (Appendix[1] 19, 47).

On March 5, 1908 a receiver was appointed for Western Maryland Rail Road Company, the "old company", when it became apparent that it would be unable to meet the interest due April 1, 1908 on its $10,000,000 of General Lien and Convertible 4% Bonds.

A protective committee was immediately formed (Exhibit 1, Appendix 49) which solicited and obtained deposit of the defaulted bonds at The Equitable Trust Company of New York, the designated depositary of the committee. The depositary issued negotiable Certificates of Deposit to the bondholders. The committee was authorized to prepare a reorganization plan (Appendix 56-7), and was given "discretion" by the depositing bondholders to "recognize and make provision for the stock of said railroad company" (Appendix 67). Accordingly the plan, instead of leaving the stockholders of the old company out, took note of "the equity represented by the old common stock" (Appendix 71) and thereupon included the old stockholders as well as the old bondholders in the reorganization provisions.

The plan of reorganization, insofar as is material here, provided:

> (1) That the property of the old company would be transferred by means of foreclosure of the mortgage underlying the defaulted General Lien and Convertible Bonds, to a newly organized company (the "new company") which would issue $10,000,000 of $100 par value new preferred stock, and $23,959,560 of $100 par value

[1] Unless otherwise indicated all references are to exhibits and page numbers as they appear in Petitioner's Appendix as printed for the Court of Appeals.

new common stock "* * * in acquisition of the *property* of the old company * * *" (Appendix 67-8).

(2) That $8,274,160 of new money capital required to support the plan would be raised from the old stockholders and bondholders as described below (Appendix 67-8).

(3) That the $10,000,000 of new preferred stock would be issued in exchange for the Certificates of Deposit for the defaulted General Lien and Convertible Bonds (Appendix 68).

(4) That $15,685,400 par value of the new common stock would be issued to the old common stockholders "in exchange for their old common stock and on payment" of $40 per share "in cash" (Appendix 68). This cash payment would provide $6,274,160 of the required new money.

(5) That $5,000,000 par value of the new common stock would be sold to the old bondholders at $40 per share, each $1,000 Certificate of Deposit entitling the holder to purchase $500 par value of the new common stock (Appendix 68). This would raise $2,000,000 of the new money required.

(6) The remaining $3,274,160 par value of new common stock was to be issued for defaulted interest coupons on the General Lien and Convertible Bonds ($836,000), and for "expenses of the reorganization, compensations, underwriting and other commissions and for reserve" ($2,438,160) (Appendix 70).

The stockholders of the old company accepted the proposals of the plan by depositing their stock, endorsed for transfer, with the committee's depositary, The Equitable

Trust Company of New York, receiving negotiable Deposit Receipts as evidence of the transaction (Appendix 82). They also paid to the depositary for the account of the new company, as the Government conceded at the trial (Appendix 184-7), the $6,274,160 in new money.

The holders of Certificates of Deposit for the defaulted General Lien and Convertible Bonds, were, of course, already committed to the committee's reorganization plan by the deposit of their bonds, subject to their right to dissent or withdraw (Appendix 58-9). They did not dissent and paid in the $2,000,000 in new money as the price of the common stock sold to them (Appendix 128-9, 184-7).

The reorganization plan was carried out as proposed, and the new company, as of January 1, 1910 (Appendix 30) took over the old company's property, issuing its $10,000,000 of preferred stock to the holders of Certificates of Deposit for the defaulted General Lien and Convertible bonds, and $15,685,400 of its common stock to the holders of Deposit Receipts for the common stock of the old company (Appendix 12, 128, 148). The balance of the new common was also issued in accordance with the plan.

On these facts the Commissioner of Internal Revenue determined that Petitioner's equity invested capital consisted only of 10,000 shares of preferred stock having a fair market value of $7,000,000, and 239,595.6 shares of common stock having a fair market value of $12,518,870.10 (Appendix 48). His notification to Petitioner of his final determination of its equity invested capital is as follows:

COMPUTATION OF ADJUSTMENT TO INVESTED CAPITAL IN CONNECTION WITH THE 1909-10 REORGANIZATION

New Preferred & Common Stock is included as follows:	
100,000 shares new 4% Preferred issued for $10,000,000 defaulted General Lien and Convertible bonds 100,000 at $70[1]	$ 7,000,000.00
New $100 par Common:	
In exchange for old Common stock 156,854 at $52.25[1] per share	8,195,621.50
To General Lien & Convertible Bondholders on payment of $40 per share 50,000 at $52.25 per share	2,612,500.00
To General Lien & Convertible Bondholders for overdue interest 8,360 at $52.25 per share	436,810.00
To Reorganization Committee for Commissions and expenses 24,381.6 at $52.25	1,273,938.60
TOTAL	$19,518,870.10

(Appendix 24)

[1] The Commissioner fixed $70 per share as the fair market value of the new preferred stock, as of January 1, 1910, and $52.25 per share as the fair market value of the new common stock at the same time (Appendix 3).

It will be observed that in the foregoing notice the Commissioner included in Petitioner's equity invested capital the sum of $2,000,000 of money paid in by the holders of the Certificates of Deposit for the defaulted General Lien and Convertible Bonds (third item of the notice), although he treated the stock issued for this money as if it had been issued for property other than money, by determining its fair market value. But the sum of $6,274,160 in money admittedly (Appendix 184-5) paid in by the holders of

Deposit Receipts for the common stock of the old company, at the same time the bondholders paid in their money, and to the same depositary (Exhibit 5, Appendix 81), was not included in Petitioner's equity invested capital.

So far as is material here, the Petitioner contended in the Courts below that under the statute and the regulations (quoted supra page 2) these preferred and common stocks could be included in its equity invested capital at their fair market valuation, only as being the measure of the cost of acquiring the property, other than money, of the old company. Therefore, the amount determined by the Commissioner for "new $100 par Common: In exchange for old Common stock * * *" (Second item of the notice) represented, and correctly under Section 718(a)(2), the *property other than money* paid in by the old common stockholders, namely, the interest which they had retained in the assets of the old company through the deposit of their shares under the reorganization plan. Since Section 718(a) says perfectly clearly that equity invested capital shall be the "sum of" money *and* property other than money paid in, Petitioner contended that it is entitled to have the *money* admittedly paid in by the old common stockholders ($6,274,160) also included in its equity invested capital, as money paid in for stock, or as a contribution to capital under Section 718(a)(1).

The Government contended that the foreclosure wiped out the common stockholders (despite the fact that the reorganization plan recognized that they had an equity in the old company, and preserved it by expressly including them with the bondholders in the reorganization, through deposit of their shares under the reorganization plan); that the new common stock was issued to the old stockholders only for money paid in in the amount of $40 per share, because the old common stockholders had no equity in the

old company and, therefore, had nothing to pay for the new stock except the money (despite the fact that the plan of reorganization expressly said that they "shall pay for the same by surrender and transfer of their shares of old stock in said Western Maryland Rail Road Company in equal par amounts, and payment of $40 per share for the new stock * * *" (Appendix 82)); therefore, when the Commissioner of Internal Revenue included in equity invested capital the new common stock issued to the old stockholders at its fair market value on January 1, 1910 ($52.25 per share), he allowed more than Petitioner was entitled to, because the stock should have been considered as issued for money only and, consequently not more than $40 per share, or $6,274,160 total, should have been included in equity invested capital on account of this stock.

The District Court decided (Appendix 37-40) that the money paid in to the Reorganization Committee by the holders of Deposit Receipts for the old common stock, and Certificates of Deposit for the defaulted General Lien and Convertible Bonds, had the effect of improving the fair market value of the new common stock. Consequently, when such improved fair market value was determined as Petitioner's equity invested capital to the extent represented by common stock, it "included the $40 per share cash which was paid in" (Appendix 38).

The Court of Appeals in a per curiam opinion simply stated that the District Court had properly decided against Petitioner on this issue (Page 18, post.)

ARGUMENT

I.

This petition brings up an important question of Federal Tax law which should be, but has not been settled by this Court.

The proper application of the statutory directions for determining a correct excess profits credit, is, of course, fundamental, and is the starting point for the calculation of excess profits tax liabilities.

An interpretation of the requirements for ascertaining an excess profits credit, under the invested capital method, which permits the Commissioner to defeat the express language of the statute, should not be tolerated. That is to say, if the Commissioner can defend his failure to calculate the "sum of" such elements of equity invested capital as are present in any instance, by merely asserting that one element is included in another (even when the statute specifically says that element may not be included), the statute is easily set at naught and taxpayers may be required to pay large sums of money not due.

The decision in this case would make such a result possible, and this may furnish the Commissioner with an effective means of justifying almost any equity invested capital determination.

This is certainly not the way in which the meaning of Section 718(a) has been viewed by the lower Courts so far.

For instance, in *Black Hills Power and Light Company* (1950) 14 T. C. 1425, the Tax Court held that the Commissioner could not lump all the steps of a reorganization together and arrive at the conclusion that equity invested capital consisted only of money paid in. The Court said:

> "Section 718(a) provides that equity invested capital shall include money paid in for stock *and also* property other than money paid in for stock. (1426) * * * Since property was actually paid in for the stock, that property *must be* included in equity invested capital 'in an amount equal to its basis (unadjusted) for determining loss upon the sale or exchange'." (1427) (Italics ours.)

If property, other than money, actually paid in "must" be included in equity invested capital to satisfy the requirements of Section 718(a), then certainly money actually paid in is an equally necessary element.

In *Tennessee Products Corporation v. United States* (1952) 107 Fed. Supp. 578, the Court of Claims said that the Commissioner could not treat a reorganization so as to omit including property paid in in his calculation of taxpayer's equity invested capital.

And in *San Marcos Hotel Company v. Commissioner* (1953) 205 Fed. 2nd 641, the Court of Appeals for the Ninth Circuit obviously regarded the statute literally when it said "equity invested capital is defined as the *sum of* money *and* other property paid in for stock, or as paid in surplus or as a contribution to capital * * *". (Italics ours.)

So far as Petitioner is aware this Court has rendered only three decisions upon the World War II Excess Profits Tax. *Commissioner v. South Texas Land Company* (1948) 333 U. S. 496 involved the treatment of instalment sales in the determination of the accumulated earnings and profits element of equity invested capital, which was described by the Court as a matter "of importance in tax administration." *U. S. v. Koppers Company* (1955) 348 U. S. 254, decided the question of when an abatement under Section 722 is effective, about which the lower courts were in conflict.

The other case (*Brown Shoe Company v. Commissioner* (1950) 339 U. S. 583) is more fully referred to later.[1]

A decision upon whether Section 718(a) means what it says, or may be so interpreted that equity invested capital is not "the sum of" the prescribed elements, but as a practical matter is whatever the Commissioner determines it to be, is certainly of equal importance with the subjects already decided. Petitioner submits that whether Section 718(a) is thus in effect a nullity, is a matter of tax law of sufficient importance to be considered and ruled upon by this Court.

II.

The decision below is in conflict with the way in which Section 718(a) of the Internal Revenue Code of 1939 has been construed by this Court.

In *Brown Shoe Company v. Commissioner*, (1950) 339 U. S. 583, the Commissioner of Internal Revenue had determined that money and property contributed to a corporation could not be included in its equity invested capital "as a contribution to capital", unless the owners of the business, that is the stockholders, were the source of the contribution. This Court rejected this "constricted" concept of capital, observing that the transfers to the corporation "manifested a definite purpose to enlarge the working capital of the company" (339 U. S. 591). This Court thus decided that Section 718(a) should not be narrowly construed to prevent a taxpayer from including in its statutory equity invested capital "values which are properly 'treated as his investment' " (339 U. S. 592).

[1] We note that in all of these cases certiorari was granted after repeal of the World War II Excess Profits Tax, that in the Koppers case being as late as June 1, 1954.

The present petition brings to this Court another instance in which a "constricted" construction has been given to Section 718(a), and which clearly has the effect of excluding from equity invested capital, assets (money) necessarily designed to "enlarge the working capital of the company".

Section 718(a) of the Internal Revenue Code to the extent here material, provides that equity invested capital "shall be the *sum* of the following amounts:

> (1). "MONEY PAID IN — Money previously paid in for stock, or as paid in surplus, or as a contribution to capital";
>
> (2) "PROPERTY PAID IN — Property (other than money) previously paid in (regardless of the time paid in) for stock, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange * * *."

This obviously means that *both* money *and* property other than money are *required* to be included in the determination of equity invested capital if both are "paid in". And in order that there can be a "sum" of the two elements, each must obviously be separately considered and valued.

"Money" paid in is accounted for as money at its dollar value. The statute for obvious reasons provides no special means for determining the value of "money".

"Property (other than money)" paid in, on the other hand, presents a question of ascertaining its value, and the statute provides that it is to be included at its basis for determining "loss upon sale or exchange". On referring to Section 113(a) of the Internal Revenue Code of 1939, it will be found that "the basis of property shall be the *cost* of such property", unless one of some twenty-two exceptions to the cost basis applies. The Government agreed with

Petitioner in the courts below that none of these exceptions are applicable to the facts of this case. Consequently "cost" is the basis to be used, and Regulations 112, Section 35.718-1, which prescribes the means for application of Section 718 (a)(2) provides:

> "For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. * * *
>
> "If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. * * *"

It is obvious from these provisions that not only are money and property other than money required by the language of the statute and regulations to be separately included in equity invested capital, but the method of determining the effect of each on equity invested capital necessitates that they be separately ascertained.

Despite the plain effect of the law and regulations, the Court below has held that equity invested capital need *not* be the "sum of" the money and property paid in. Under its decision, although money is actually paid in, a determination made for property other than money paid in, valued in accordance with the regulations at its cost in terms of the fair market value of stock issued to acquire such property, may be the sole element of equity invested capital, thus setting the statute at naught. Money admittedly paid in with the "definite purpose to enlarge the working capital of the company" may be excluded from equity invested capital by the device of describing it as merely a portion of the cost of property paid in even though the statute says this element must exclude money. This is plainly contrary to the principles announced by this Court in the *Brown Shoe Company* case.

CONCLUSION

This petition seeks a decision from this Court that Section 718(a) means what it says, and that the Commissioner of Internal Revenue *must* include in equity invested capital "the sum of" the elements defined by the statute, when the facts disclose them to be present. The cost of *property other than money* paid in, which is its value for equity invested capital purposes in most instances, obviously cannot, consistently with the language of the statute, also measure the amount of *money* paid in. The two elements are essentially different in nature and for that reason were separately provided for in the statute. The decision below treats them as if they were identical although the statute specifically says they cannot be identical.

Petitioner submits that this is a basic misconstruction of the statute on a matter of fundamental importance in excess profits tax administration. It is at variance with the accepted construction of the statute in other cases.

Respectfully submitted,

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Baltimore, Maryland

March 2, 1956

APPENDIX A

UNITED STATES COURT OF APPEALS
For the Fourth Circuit

WESTERN MARYLAND RAILWAY COMPANY, *Appellant*,

v.

UNITED STATES OF AMERICA, *Appellee*.

(Three Cases)

Nos. 7081-7083

(Argued November 14, 1955. Decided December 6. 1955.)

Before PARKER, Chief Judge, and SOPER and DOBIE, Circuit Judges.

PER CURIAM:

These are appeals by the Western Maryland Railway Company from adverse judgments in suits instituted to recover an alleged overpayment of excess profits taxes for the years 1943, 1944 and 1945. The claim of taxpayer in each case is based upon the contention that the Commissioner of Internal Revenue failed to include a sufficient amount in equity invested capital. The controversy relates to an equity reorganization of the Western Maryland Railroad occurring in the years 1909 and 1910, when the taxpayer purchased property of the prior corporation from a reorgani-

zation committee, assuming all the indebtedness of the old company superior to its general lien mortgage and issuing common and preferred stock in payment. The facts are fully and accurately stated in the opinion of the District Judge and need not be repeated here. See Western Maryland Railway Company, 131 F. Supp. 873.

Three questions are presented by this appeal: (1) Where the holders of common stock or general lien bonds of the old company paid to the reorganization committee $40 per share for common stock of the old company for which the new company exchanged its common stock share for share, was the taxpayer entitled to have the $40 per share included in equity invested capital in addition to the $52.50 per share as the value of the new shares, which was the amount allowed by the Commissioner? (2) Was the taxpayer entitled to have included in its equity invested capital the amount by which the general lien bonds of the old company (the payment of which was not assumed by the new company) exceeded in value the preferred stock of the new company exchanged therefor? and (3) should the preferred stock of the new company issued to the holders of general lien bonds have been valued at $73.50 per share instead of at $70 per share, as valued by the Commissioner? We think that all of these questions were properly answered in the negative for reasons adequately stated in the opinion of the District Judge. The only one as to which there could be any reasonable question is the one last mentioned, relating to the value of the preferred stock; but in view of the facts in evidence and the determination of the Commissioner, which is presumptively correct, we do not think that we would be justified in disturbing the valuation placed thereon by the District Judge. Furthermore, the difference, if allowed, would amount to only $350,000; and this would not help taxpayer, since the Commissioner allowed $1,273,938.80 for stock issued for commissions and services in the reorganization, which is not properly includible in the equity invested capital of the new corporation. *Bard-Parker Co. v. Commission*, 2 Cir. 218 F. 2d 52, 58; *Gabriel Co. v. Commissioner*, 6 Cir. 186 F. 2d 786; *Warner Co. v. Commissioner*, 11 T.C.

419, 433, aff. 3 Cir. 181 F. 2d 599; *Palomar Laundry Co. v. Commissioner*, 7 T.C. 1300; *La Belle Iron Works v. United States*, 256 U. S. 377, 389-390. As the suits in the court below were instituted on the theory that there had been an overpayment of excess profits taxes during the years in question because taxpayer had not been allowed a sufficient amount as equity invested capital, it would be proper to consider that stock issued for services was improperly included in that item if any other item included therein should be increased in amount.

Affirmed.

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380728—56——1

In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 733

WESTERN MARYLAND RAILWAY COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 3–44[1]) is reported at 131 F. Supp. 873. The opinion of the Court of Appeals (Pet. App. 17–19) is reported at 227 F. 2d 576.

JURISDICTION

The judgment of the Court of Appeals was entered December 6, 1955. (Pet. 17.) The peti-

[1] Record references used herein are to the appendix to the taxpayer's brief in the Court of Appeals. Supplemental record references are to Appendix B to the Government's brief in the same court.

tion for a writ of certiorari was filed on March 5, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether the finding of the District Court, affirmed by the Court of Appeals, as to the amount of petitioner's equity invested capital allowable under Section 718 of the Internal Revenue Code of 1939 for excess profits tax purposes is supported by the evidence.

STATUTES AND REGULATIONS INVOLVED

The statutory provisions involved are Sections 113 (a) and 718 (a) of the Internal Revenue Code of 1939, and the Treasury Regulations involved are Treasury Regulations 112, Section 35.718–1, which are set forth in the Appendix, *infra,* pp. 19–20.

STATEMENT

Petitioner is the successor[2] of a railroad corporation which in 1910 acquired the property of the Western Maryland Rail Road Company (hereafter sometimes call the "Old Company") as the result of a foreclosure sale. As of March 5, 1908, the Old Company had outstanding $48,718,000 First Mortgage and Divisional Bonds; $2,233,950 Underlying or Leased Line Bonds and

[2] Since petitioner is entitled to include the invested capital of its predecessor (R. 47), for convenience both corporations are sometimes referred to as the "taxpayer" or the "New Company."

Guaranteed Stocks; $10,000,000 General Lien and Convertible 4% Mortgage Bonds (herein referred to as General Lien Bonds), secured by the same properties as the First Mortgage Bonds but subject thereto; and $15,685,400 par value common stock (par $50) (R. 4, 66–67). On that date the trustees under the mortgage securing the General Lien Bonds brought suit to foreclose the mortgage and to appoint a receiver, because of the inability of the Old Company to meet bond interest to become due. The complaint also alleged that the company was insolvent. (R. 4; Supp. R. 15–17.) On the same day the court appointed a receiver for the properties covered by the General Lien Mortgage (R. 4, 48). The anticipated defaults later occurred (Supp. R. 17–22).

Pending the foreclosure a Committee of General Lien Mortgage Bondholders was formed to protect the interests of depositing bondholders (R. 5, 49–60). On July 26, 1909, the Committee submitted to the bondholders a Reorganization Plan (R. 64). After noting in the Plan that the foreclosure proceedings were "well advanced toward final decrees" (R. 65), it stated (R. 6, 67–68):

> It is proposed to effect the reorganization of the [Old] Company by the organization of a new company which shall take over the property of the old company subject to its First Mortgage and its underlying and divisional bonds as specified in the foregoing [financial] statement.
>
> The new company will issue in acquisition of the property of the old company:
>
> $10,000,000 Four Per Cent. Non-Cumulative Preferred Stock

(par value $100), preferred * * *, convertible * * *, redeemable * * *, and

$23,939,500 Common Stock (par value $100) of an authorized issue of $50,000,000.

The holders of certificates of deposit for General Lien and Convertible 4% Bonds will receive:

(a) For principal, 100%, viz: $10,000,000, in new 4% preferred stock,

(b) For unpaid overdue coupons * * * $836,000 [par value], in new common stock.

The required $8,274,160 cash will be raised by sale of $20,685,400 of common stock to a Banker's Syndicate under the management of Blair & Co. who will offer the same as follows:

(a) To the holders of certificates of deposit for $10,000,000 Western Maryland General Lien and Convertible Bonds 50% of their holdings, *i. e.*: $5,000,000 new stock, for 40% of its par value, or	$2,000,000
(b) To the holders of $15,685,400 Western Maryland stock, in exchange for their old stock and on payment of 40% of the par value thereof in cash, 100% of their holdings, *i. e.*: $15,685,400 new common stock for	$6,274,160
	$8,274,160

In addition, the Plan contemplated that the New Company would issue $2,438,160 par value of the new common stock "for expenses of reorganization, compensations, underwriting and other commissions and for reserve" (R. 7, 70).

The Plan also contemplated that the $8,274,160 raised by the sale of the new common stock at $40 per share (as set forth above) would to the extent of $6,762,297 be used to pay obligations incurred by the Receiver between March 1908 and July 1909, for interest on the First Mortgage Bonds, and for equipment and car trust certificates and other secured obligations, while the balance of $1,511,863 would be used for "Improvements and for Current and Miscellaneous

Requirements in Reorganization" (R. 7, 66–67). The Plan made no provision for payment of $1,714,091 of creditors' claims, which it characterized as "Disputed or Forecloseable Claims" (R. 7, 67). Neither the Bondholders' Committee nor anyone representing the Old Company filed the Committee's Plan with the court prior to the foreclosure decree or as an incident to the foreclosure proceedings (R. 95–111; Supp. R. 23–30), and the foreclosure decree made no reference to it.

The Committee entered into an agreement with Blair & Company, as managers for a Bankers' Stock Purchase Syndicate, providing for the sale to the Syndicate, if and when issued, for $8,274,160 in cash, of $20,685,400 par value common stock of the proposed New Company, i. e., at $40 per share, "to be issued as and for the purposes contemplated in the Plan." The Syndicate agreed to offer the stock to the General Lien bondholders and to the stockholders of the Old Company, as provided in the Plan. (R. 7, 74–81.) The Syndicate notified the holders of the certificates of deposit for the General Lien Bonds and the common stockholders of the Old Company of the Reorganization Plan and of their offer to sell to them the new common stock, par value $100, at $40 per share, to be paid in four equal monthly $10 installments on the first days of September, October, November and December, 1909 (R. 7–8, 84–89). By January 1, 1910,

holders of 309,977 of the 313,708 outstanding shares of common stock (par. $50) of the Old Company had deposited their shares under the Plan (R. 8).

On October 9, 1909, upon a report of a special master (Supp. R. 23–24), the Circuit Court entered a Foreclosure Decree, which ordered payment of $10,894,022.23 principal and interest on the General Lien Bonds within five days, and upon default of such payment that all the properties of the Old Company covered by the mortgage be sold, subject to specified superior liens (R. 8, 95–111). The decree then provided for the sale of the property at public auction, and fixed an upset price of $6,500,000 of which at least $250,000 was to be paid in cash (R. 9, 102–103). As part of the purchase price, the purchaser was to assume all secured indebtedness of the Rail Road Company superior to the General Lien Bonds and all unpaid compensation, expenses and obligations of the Receiver (R. 9, 105–107). The decree then provided for the delivery to the purchaser of a deed to the property free from all the liens and claims except as in the decree expressly reserved (R. 9, 109).

Pursuant to the foreclosure decree, on November 19, 1909, the special master sold the mortgaged properties to Henry E. Cooper and Frank C. Nicodemus, Jr., representing the Bondholders' Committee, the only bidders, for $6,500,000 and the court approved the sale (R. 10; Supp. R. 25,

26). On December 1, 1909, Cooper, Nicodemus, and others formed a new corporation under the name The Western Maryland Railroad Company (the taxpayer) with authorized $10,000,000 par value preferred stock ($100 par each) and $50,000,000 par value common stock ($100 par each) to acquire and operate the railroad properties formerly belonging to the Old Company and purchased at the foreclosure sale (R. 10, 111–114). On December 29, 1909, Cooper and Nicodemus assigned to the New Company all of their title and interest as purchasers of the properties at the foreclosure sale, in consideration of $1 and the assumption by the New Company of the purchasers' obligations under the foreclosure decree (R. 10–11, 114–116).

On December 30, 1909, the New Company received a deed to the properties previously covered by the General Lien Mortgage, subject only to the first mortgage and other superior liens and to the condition that it pay or assume the Receiver's obligations (R. 11, 117–125).

As of January 1, 1910, the New Company opened its books and provided for the issuance of the preferred and common stock as provided in the Plan and the various agreements made pursuant thereto (R. 12, 148). On January 21, 1910, the Special Master reported that in payment of the $6,500,000 price accepted on the foreclosure, Cooper and Nicodemus had delivered to him a cer-

tificate of deposit issued by The Equitable Trust Company of New York for $9,930,000 face value in General Lien Bonds, and that the bonds and attached coupons had then been delivered to him and stamped: "Paid on this bond with coupons maturing April 1, 1908, and subsequently, $650, out of the proceeds of the foreclosure sale made November 19, 1909, of the property mortgaged to secure the same" (R. 11; Supp. R. 27–28). He also reported that, of the remaining $70,000 in face value not covered by the certificate of deposit, 19 bonds totaling $19,000 face value were turned in to the depositary and the bondholders paid $650 on each bond; that 51 bonds, totaling $51,000, were still outstanding and that there was due the holders $650 for each, or a total of $33,150, which amount he was depositing with the court. He then turned over to the New Company the sum of $204,168.50, being the balance of the $250,000 cash deposit made by Cooper and Nicodemus, the original purchasers. (R. 11–12; Supp. R. 29–30.)

On May 29, 1911, the taxpayer filed a petition with the court setting forth that the Old Company still had property valued at $151,333.57 not covered by the foreclosed mortgage; that in the foreclosure suit there was $1,810,123.25 in claims of creditors allowed but still unpaid; that there were also unfiled and unpaid claims and judgments against the Old Company totaling $45,604.61; and that there were also claims of bondholders who failed to deposit under the Plan bonds of face value

$70,000 and who had been paid only $650 cash, or a total of $45,500. These constituted all the claims to which the residuary property was subject. The taxpayer then asserted that it had become the owner of these claims,[3] with the exception of the $70,000 of bonds and hence was the substantial equitable owner of the property. (R. 18; Supp. R. 32.) On the same day the court entered an order entitling the holders of the 70 bonds to the option of receiving preferred stock and common stock as set forth in the Reorganization Plan, or in the alternative $20 in cash for each $1,000 bond, and transferring all of the remaining railroad property to the taxpayer (R. 18; Supp. R. 31–34). By December, 1912, holders of 69 of the 70 bonds had surrendered them for preferred and common stock (R. 18, 155, 189).

In the computation of the taxpayer's invested capital the Commissioner of Internal Revenue allowed the following sums as having been paid in upon the issuance as of January 1, 1910, of the preferred and common stock of the Western Maryland Railway Company as a result of the transactions discussed herein (R. 23, 48):

Invested capital paid in for 100,000 shares of $100 par value preferred stock	$7,000,000.00
Invested capital paid in for 239,595.6 shares of $100 par value common stock	12,518,870.10
Total	$19,518,870.10

[3] The District Court stated that the taxpayer "evidently had purchased [the $1,855,727.86 in claims against the Old Company] as cheaply as possible, probably for about $20,000." (R. 18; Supp. R. 45.)

In making the foregoing allowance, the Commissioner determined the fair market value of the preferred stock on January 1, 1910, to be $70 per share, and that of the common stock to be $52.25 per share (R. 23, 48)[4]

The taxpayer claimed invested capital credit for the years 1943, 1944 and 1945 in amounts in excess of the Commissioner's allowance, and paid the resulting excess profits tax deficiencies determined by the Commissioner. It also subsequently claimed that it was entitled to carry back an unused excess profits credit from 1946 to 1944, and to carry over an unused excess profits credit from 1941 to 1943 (R. 45, 46). Upon denial of its claims for refund the taxpayer brought these

[4] The revenue agent's report computed the invested capital, on the basis of these values, as follows (R. 23–24):

Computation of Adjustment to Invested Capital in Connection with the 1909–10 Reorganization

New Preferred & Common Stock is included as follows:	
100,000 shares new 4% Preferred issued for $10,000,000.00 defaulted General Lien & Convertible bonds 100,000 at $70.00	$7,000,000.00
New $100 par Common:	
In exchange for old Common Stock 156,854 at $52.25 per share	8,195,621.50
To General Lien & Convertible Bondholders on payment of $40.00 per share 50,000 at $52.25 per share	2,612,500.00
To General lien (sic) & Convertible Bondholders for overdue interest 8,360 at $52.25 per share	436,810.00
To reorganization Committee for Commissions and expenses 24,381.6 at $52.25	1,273,938.60
Total	$19,518,870.10

actions, which were consolidated for trial (R. 46, 47).

At the trial taxpayer contended, among other things,[5] that, in addition to the $52.25 fair market value per share of common stock of the New Company which the Commissioner allowed, it was also entitled to have allowed as invested capital the $40 cash which was paid for each share. The District Court found that the $52.25 already reflected the money as well as the value of the property paid in and that, since the equity of the stockholders of the Old Company in the railroad property had little or no value after the foreclosure, the Commissioner allowed taxpayer as much or more than it was entitled to when he allowed $52.25 per share as the value of the common stock of the New Company. (R. 38–40.) The District Court accordingly granted judgment for the United States (R. 1–2). The Court of Appeals affirmed in a *per curiam opinion* (Pet. App. 17–19).

ARGUMENT

This case presents a question of fact, namely, the value of stock issued by taxpayer corporation upon its organization, for purposes of determing its equity invested capital. The decision below, affirming the decision of the District Court, is

[5] Other contentions advanced below by the taxpayer (and rejected by both courts below) have been abandoned in the petition.

correct. There is no conflict, and no occasion for further review.

1. Section 718 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 19) defines equity invested capital, for purposes of computing the corporate excess profits tax credit under the World War II Excess Profits Tax Statute,[6] as the sum of money and property paid in for stock. It further provides that property paid in is to be included in equity invested capital in an amount equal to its unadjusted basis for determining loss upon a sale or exchange—in this instance cost.[7] The applicable Treasury Regulations (Section 35.718–1 of Regulations 112 (Appendix, *infra*, p. 20)) provide that where stock issued for property had an established market value, the cost of the property is deemed the fair market value of the stock at the time of its issuance.

In this case, the taxpayer upon its organization in 1910 issued preferred and common stock in exchange for property and money. The property consisted of the mortgaged assets of an insolvent corporation (the Old Company) purchased upon a foreclosure sale by a bondholders committee, which in turn transferred the assets (subject to superior liens) to taxpayer pursuant to a reorgan-

[6] The tax was repealed for taxable years after 1945 by Section 122 of the Revenue Act of 1945, c. 453, 59 Stat. 556.

[7] Section 113 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 19) provides that "The basis of property shall be the cost of such property," with exceptions not here applicable.

ization plan. The money was contributed partly by the bondholders, who received all of taxpayer's preferred stock and purchased some of its common shares, and partly by the common stockholders of the Old Company or their transferees, whose equity interests were wiped out by the foreclosure sale. After a painstaking analysis of the evidence the District Court, sustaining the Commissioner's determination, found that the fair market value of taxpayer's common stock issued upon its organization did not exceed $52.25 per share, and that this price reflected both the money and the property received by taxpayer in exchange for the stock (R. 37–40). These findings are amply supported by the record, and the court below properly refused to disturb them (Pet. App. 17–19).

Discarding other arguments advanced below, taxpayer in its petition now contends that the fair market value of its common stock, which the Commissioner and both courts below found did not exceed $52.25 per share, is attributable in its entirety to the property received by taxpayer, and that an additional $40 per share should be added to that value to represent the money paid by the old common stockholders for shares of taxpayer's common stock. It asserts such claim on the untenable theory that where (as here) stock is issued for a combination of money and property, the statute and the Treasury Regulations require that the entire value of the stock be allocated to the property alone, that the money paid

in then be added to that value, and that the resulting "sum" represents the equity invested capital. In so contending, taxpayer completely ignores the finding below (R. 40) that "the allowance by the Commissioner [$52.25 per share of common] obviously included the $40 per share of cash, and Plaintiff is not entitled to an additional allowance for that amount", as well as the evidence upon which that finding rests.[8]

Indeed, in allowing $52.25 per share as invested capital paid in for the common stock, the Commissioner was exceedingly generous. As the District Court found (R. 38), the Old Company had been hopelessly insolvent in 1908–1909. The foreclosure sale had netted less than two-thirds of the face amount of the $10,000,000 of General Lien Bonds, with nothing left for more than $1,800,000 in claims of general creditors (R. 38–

[8] Contrary to the taxpayer's assumption (Pet. 8–9), the District Court found (R. 38) that the Commissioner did not fail to allow invested capital credit for the $6,274,160 in cash paid in by the common stockholders of the Old Company. As the District Court further found (R. 38), the Commissioner did not fix $8,195,621.50 as the fair market value of the assets of the Old Company. He fixed $52.25 as the fair market value at January 1, 1910, of the common stock of the New Company, $8,195,621.50 as the fair market value of 156,854 shares of such stock, and $12,518,870.10 as the fair market value of the total of 239,595.6 shares of common stock issued at that time. The $52.25 value included the $40 per share cash already paid in as of January 1, 1910, by the depositing stockholders (or their transferees) in the Old Company and by the original holders (or transferees) of warrants issued to the General Lien bondholders.

39) or for holders of common stock. General Lien Bondholders who did not deposit under the Plan received but $650 per bond, i. e., their proportionate share of the foreclosure sale price. (R. 11, 18; Supp. R. 27–30.) Thus the old common stockholders, who were permitted by the bondholders' committee to purchase new common stock at $40 per share, had no remaining equity in the railroad property to pay in to the New Company. Since no provision was made for the payment of the general creditors, it would indeed have been wholly improper for the committee to have preserved any interest of value in the foreclosed property for the common stockholders. *Northern Pacific Ry.* v. *Boyd,* 228 U. S. 482; *Louisville Trust Co.* v. *Louisville &c. R'y,* 174 U. S. 674, 683, 684. The committee likewise gave the bondholders the identical privilege of subscribing to the common stock of the New Company at $40 per share, and taxpayer recognizes that the bondholders paid only cash for the stock (Pet. 7, 8). The District Court properly concluded that the old common stockholders and the bondholders were given the right to subscribe to the new stock at $40 per share, not because they put anything into the New Company in addition to the cash, but merely because they were "the persons most likely to subscribe" (R. 39), a conclusion reinforced by the quotations on the New York Stock Exchange between July, 1909, and January, 1910, for the stock of the Old Company

and for deposit receipts and warrants for purchase of the common stock of the New Company.[9]

Even assuming that the stockholders of the Old Company paid in something in property to the New Company, in addition to the $40 cash per share, taxpayer offered not the slightest evidence which would establish that such property had value in excess of the $12.25 per share allowed by the Commissioner in determining a total value of $52.25 per share. Instead it has relied and continues to rely on nothing more than a

[9] After the reorganization plan was presented by the bondholders' committee on July 6, 1909, the common stock of the Old Company, which sold at a mean of 4 15/16 on that day, steadily declined until at the end of July its average price was only 1 29/32. Through August and September the price ranged between one and six. (R. 39; Supp. R. 10–12.) Those stockholders of the Old Company who desired to avail themselves of the privilege of purchasing the shares of stock of the new were required to surrender their stock certificates and make a down payment of $10 per share of the new stock by September 27, 1909, for which they were to receive transferable purchase warrants. And additional $10 installments were then to be paid in on October, November and December 1, 1909. (R. 91, 92.) When the first published prices for the warrants appeared on the New York Stock Exchange on October 9, 1909, they reflected sales at only $1 in excess of the $20 the holders had up to then been required to put up and did not vary significantly from this price throughout October. (R. 39; Supp. R. 2.) In November, 1909, after payment of the third $10 installment, the warrants sold between $31 and $34. In December, after payment of the full $40, the price went to $43. (R. 39; Supp. R. 3–4.) It is apparent, therefore, as the District Court pointed out (R. 39), that no substantial value was placed upon the right to acquire the new stock.

tenuous interpretation of an isolated segment of a revenue agent's report (R. 25–26; Pet. 8–9). Under well established principles, a taxpayer is not entitled to a tax refund unless he can prove an overpayment, apart from any real or purported error of the Commissioner. *Reinecke* v. *Spalding,* 280 U. S. 227; *Lewis* v. *Reynolds,* 284 U. S. 281; *Stone* v. *White,* 301 U. S. 532, 538; *Helvering* v. *Taylor,* 293 U. S. 507, 514.

2. The lone case upon which taxpayer relies (Pet. 13–15) for conflict (*Brown Shoe Co.* v. *Commissioner,* 339 U. S. 583) presented an issue far removed from that here presented. The question there was whether money and property contributed to a corporation by community groups was includible in its equity invested capital, and the Court held (pp. 592–593) that invested capital may include voluntary contributions by outsiders as well as capital invested by proprietors of the enterprise. No such question is here involved. Both courts below recognized that all of the money and property contributed to taxpayer was includible in its equity invested capital, and they so held. However, they properly disagreed with taxpayer's claim that the fair market value of the common stock issued in exchange, as determined by the Commissioner, reflected only the property but not the money contributed.

The only question presented by this case is one of fact. The Commissioner's determination as to the amount of petitioner's equity invested capital

under Section 718 of the Internal Revenue Code of 1939 has been affirmed by the concurrent findings of the two courts below and is entitled to finality here. *Corn Products Refining Co.* v. *Commissioner,* 350 U. S. 46, 61; *Comstock* v. *Group of Investors,* 335 U. S. 211, 214.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(26 U. S. C. 1952 ed., Sec. 113.)

SEC. 718 [As added by Sec. 201, Second Revenue Act of 1940, C. 757, 54 Stat. 974]. EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. * * *

* * * * *

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and

profits as of the beginning of such taxable year;

* * * * *

(26 U. S. C. 1952 ed., Sec. 718.)

Treasury Regulations 112, promulgated under the Internal Revenue Code of 1939:

SEC. 35.718–1 *Determination of Daily Equity Invested Capital.—Money and Property Paid in.*—The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in surplus, or as a contribution to capital. * * *

If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. If the stock had no established market value at the time of the exchange, the fair market value of the assets of the company at that time should be determined and the liabilities deducted. The resulting net worth will be deemed to represent the total value of the outstanding stock. In determining net worth for the purpose of fixing the fair market value of the stock at the time of the exchange, the property paid in for such stock shall be included in the assets at its fair market value at that time.

* * * * *

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